



AUDITOR-GENERAL  
SOUTH AFRICA

Accounting to the public

# **Ndlambe Municipality**

## **Audit Report**

For the year ended 30 June 2015

# **Report of the auditor-general to the Eastern Cape provincial legislature and the council on Ndlambe local municipality**

## **Report on the financial statements**

### **Introduction**

1. I have audited the financial statements of the Ndlambe local municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2015, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget and actual amounts for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

### **Accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2014 (Act No. 10 of 2014) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor-general's responsibility**

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the municipality's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

## **Basis for qualified audit opinion**

### **Irregular expenditure**

6. The municipality did not have adequate systems in place to identify and disclose all irregular expenditure incurred during the year as required by section 125(2) (d) (ii) of the MFMA. The irregular expenditure disclosed in note 42 to the financial statements is understated in respect of amounts incurred and identified during the audit process of R12,6 million (2014: R14,9million). Due to the lack of systems, it was impracticable for me to determine the full extent of the understatement of irregular expenditure disclosed at R39,6million (2014: R79,2million).

## **Qualified opinion**

7. In my opinion, except for the possible effects of the matters described in the basis for qualified opinion paragraph, the financial statements present fairly, in all material respects, the financial position of the Ndlambe local municipality as at 30 June 2015 and its financial performance and cash flows for the year then ended, in accordance with SA standards of GRAP and the requirements of the MFMA and DoRA.

## **Emphasis of matters**

8. I draw attention to the matters below. My opinion is not modified in respect of these matters.

### **Material losses and impairments**

9. As disclosed in note 31 to the financial statements, material losses to the amount of 16,7 million were incurred as a result of a write-off of irrecoverable trade receivables. Furthermore, note 50 to the financial statements disclose material losses of R17,1 million as a result of water and electricity reticulation losses.

### **Restatements of corresponding figures**

10. As disclosed in note 46 to the financial statements, the corresponding figures for 30 June 2014 have been restated as a result of errors discovered during 2014 and 2015 in the financial statements of the Ndlambe Municipality at, and for the year ended, 30 June 2014.

## **Additional matter**

11. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon

## Report on other legal and regulatory requirements

12. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives for selected objectives presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading, but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

## Predetermined objectives

13. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected objective presented in the annual performance report of the municipality for the year ended 30 June 2015:
- Key Performance Area (KPA) 1: Basic Service Delivery on pages x to x
14. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
15. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned objectives. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
16. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
17. The material findings in respect of the selected objective are as follows:

## Key Performance Area (KPA) 1: Basic Service Delivery

### Usefulness of reported performance information

18. Section 41(c) of the MSA requires the IDP to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 59% of the reported objectives, a total of 70% of the reported indicators, a total of 89% of the reported targets were not consistent with those in the approved IDP. This was due to the lack of a proper performance management system which led to no reviews, reconciliations and follow-ups being taken by leadership.
19. Section 54(1)(c) of the MFMA determines that the service delivery and budget implementation plan adopted by the municipal council may be amended only if the council approves an adjustments budget. Changes to the service delivery and budget implementation plan in the year have to be made in accordance with the process as prescribed per section 28 of the MFMA. Material changes were made to the objectives, indicators and targets in the annual performance report, without following the process as prescribed in section 28 of the MFMA and without adoption by the municipal council.

This was due to majority of objectives, indicators and targets being changed at the end of the year with no review of the annual report.

20. The FMPPI requires that Performance indicators and measures to be well defined by having clear data definitions so that data can be collected consistently and is easy to understand and use. In addition, performance targets must be specific in clearly identifying the nature and required level of performance and should also be measurable. A total of 100% of the indicators were not well defined and 46% of the targets were not specific and measurable. This was because management did not adhere to the requirements of the FMPPI due to a lack of proper systems and processes and technical indicator descriptions.

### Reliability of reported performance information

21. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. We were unable to obtain the information and explanations we considered necessary to satisfy ourselves as to the reliability of the reported performance information. This was due to limitations placed on the scope of our work due to the absence of information systems, the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information and the auditee's records not permitting the application of alternative audit procedures.

22. I draw attention to the following matters:

### Achievement of planned targets

23. Refer to the annual performance report on pages 54 to 114 for information on the achievement of planned targets for the year. This information should be considered in the context of the findings on usefulness and reliability of the reported performance information in paragraph 18 to 20 of this report.

### Adjustment of material misstatements

24. I identified material misstatements in the annual performance report submitted for auditing on the reported performance information for Key Performance Area (KPA) 1 – Basic Service Delivery. As management subsequently corrected only some of the misstatements, I identified material findings on the usefulness and reliability of the reported performance information.

### Unaudited supplementary information

25. The supplementary information set out on pages 1 to 53 and 115 to 121 does not form part of the annual performance report and is presented as additional information. We have not audited these schedules and, accordingly, we do not express a conclusion thereon.

### **Compliance with legislation**

26. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

## **Strategic planning and performance management**

27. The municipality did not establish a performance management system, as required by section 38(a) of the MSA.
28. The local community was not consulted by means of a municipal wide structure for community participation in drafting and implementing the Integrated development plan (IDP), as required by section 28 of the MSA and Municipal planning and performance management regulation 15(1)(a)(i).
29. The key performance indicators (KPIs) set by the municipality did not include indicators on percentage of households with access to basic level of water and sanitation as required by section 43(2) of the MSA and the Municipal planning and performance management regulation 10(a).
30. The performance management system was not in line with the priorities, objectives, indicators and targets contained in its integrated development plan and did not clarify the roles and responsibilities of each role-player and did not determine the frequency of reporting and the lines of accountability and did not relate to the employee's performance management processes and did not link to the integrated development planning processes, as required by section 38(a) of the MSA and MPPM regulation 7(2)(c-g).
31. The performance management system did not provide for the monitoring, measuring and review of performance at least once per year, as required by section 41 of the MSA.
32. The performance management system did not provide for steps of improvement where performance targets were not met, as required by section 41 (1)(d) of the MSA.
33. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.
34. Key performance indicators, including input, output and outcome indicators, in respect of each of the development priorities and objectives were not set out in the IDP, as required by section 41(1)(a) of the MSA and the MPPM regulation 1 and 9(1)(a).
35. Measurable performance targets for the financial year with regard to each of the development priorities or objectives and key performance indicators were not set in the IDP, as required by section 41(1)(b) of the MSA and the MPPM regulations 12(1) and 12(2)(e).
36. The performance management system and related controls were not in place as it did not describe and represent the processes of performance planning, monitoring, measurement, review, reporting, improvement and how it is conducted, organised and managed, including determining the roles of the different role-players, as required by sections 38 of the MSA and regulation 7 of the MPPM.
37. The annual performance agreements for the municipal manager and all senior managers are not linked to the measurable performance objectives approved with the budget and to the service delivery budget implementation plan as required in terms of section 53(1)(c)(iii) of the MFMA and section 57(1)(b) of the MSA.
38. The service delivery and budget implementation plan (SDBIP) for implementing the municipality's delivery of municipal services and annual budget did not indicate projections for each month of the revenue to be collected, by source and the operational and capital expenditure, by vote, and service delivery targets and performance indicators for each quarter as required by section 1 of the MFMA.

## **Financial statements**

39. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of non-current assets, current assets, liabilities, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records were provided but the uncorrected material misstatements resulted in the financial statements receiving a qualified opinion.

## **Audit committees**

40. A performance audit committee was not in place and the audit committee was not used to fulfil the performance audit committee function, as required by Municipal planning and performance management regulation 14(2)(a).
41. The audit committee did not review the municipality's performance management system and/or make recommendations to the council, as required by Municipal planning and performance management regulation 14(4)(a)(ii).
42. The audit committee did not review the quarterly internal audit reports on performance measurement, as required by Municipal planning and performance management regulation 14(4)(a)(i).
43. The performance audit committee did not submit, at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by Municipal planning and performance management regulation 14(4)(a)(iii).
44. The performance audit committee did not meet at least twice during the financial year, as required by Municipal planning and performance management regulation 14(3)(a).
45. The audit committee did not advise the council on matters relating to the adequacy, reliability and accuracy of financial reporting and information, as required by section 166(2)(a)(iv) of the Municipal Finance Management Act.
46. The audit committee did not advise the council on matters relating to compliance with legislation, as required by section 166(2)(a)(vii) of the Municipal Finance Management Act.
47. The audit committee did not meet at least four times a year, as required by section 166(4)(b) of the Municipal Finance Management Act.
48. The audit committee did not advise the council on matters relating to internal financial control and internal audits, risk management, accounting policies, effective governance, performance management and performance evaluation as required by section 166(2)(a) of the Municipal Finance Management Act.

## **Internal audit**

49. The internal audit unit did not function as required by section 165(2) of the MFMA, in that:
- It did not prepare a risk-based audit plan and an internal audit programme for the financial year under review.
  - It did not report to the audit committee on the implementation of the internal audit plan.
  - It did not advise the accounting officer and/or report to the audit committee on matters relating to internal audit, internal controls, accounting procedures and practices, risk and risk management and loss control.



50. The internal audit unit did not advise the accounting officer and report to the audit committee on matters relating to compliance with the MFMA, the DoRA and other applicable legislation, as required by section 165(2)(b)(vii) of the MFMA.

### **Procurement and contract management**

51. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by SCM regulation 17(a) & (c).
52. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1).
53. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
54. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA.
55. A list of accredited prospective providers was not in place for procuring goods and services through quotations as required by SCM regulation 14(1)(a).
56. The prospective providers list for procuring goods and services through quotations was not updated at least quarterly to include new suppliers that qualify for listing, and prospective providers were not invited to apply for such listing at least once a year as per the requirements of SCM regulation 14(1)(a)(ii) and 14(2).

### **Human resource management and compensation**

57. The municipality did not develop and adopt appropriate systems (policies) and procedures to monitor measure and evaluate performance of staff in contravention of section 67(d) of the MSA.

### **Expenditure management**

58. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

### **Conditional grants received**

59. The municipality did not evaluate its performance in respect of programmes funded by the Municipal Infrastructure Grant, Municipal Systems Improvement Grant and Local Government Financial Management Grant allocation, as required by section 12(5) of the DoRA.
60. Municipal Infrastructure Grant funds were retained or rolled over to the next financial year without seeking the approval of the National Treasury, as required by sections 22(1) of the DoRA.

## **Asset and liability management**

- 61. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of the MFMA.
- 62. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.

## **Consequence management**

- 63. Unauthorised, Irregular, Fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.

## **Internal control**

- 64. I considered internal control relevant to my audit of the financial statements, performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for qualified opinion, the findings on the performance report and the findings on compliance with legislation included in this report.

## **Leadership**

- 65. Leadership did not adequately discharge its oversight responsibilities with regards to the implementation and monitoring of internal controls to ensure sound financial and performance management and compliance with laws and regulations. This resulted in inaccurate, incomplete and inadequate financial and performance reporting.
- 66. Leadership has developed a plan to address external audit findings, but the implementation of the plan has not sufficiently addressed all the external audit findings raised in prior years.
- 67. Leadership has not implemented an effective performance management system that holds staff accountable and enables the leadership to instil the principle of consequence management. As a result a large number of municipal laws and regulations were not complied with.

## **Financial and performance management**

- 68. Information availed was at times either incomplete or did not support the financial statements and the performance report. For some areas under both financial and performance management the regular processes of collecting, collating and reporting on credible information were not implemented which resulted in material findings being identified on the reported financial and performance information.

## Governance

69. The implementation of the risk management strategy has not been monitored. Although a risk assessment was performed it was inadequate and not formally adopted.
70. The internal audit unit and audit committee did not enhance the credibility of the financial statements and performance reports. This is as a result of a number of factors including the lack of capacity of internal audit and inability of the audit committee to meet regularly as required by legislation.

*Auditor-General*

East London

30 November 2015



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